

In Praise of Limiting Democracy: a Defense of ISDS

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Defending sovereignty is becoming a defining generation Z subject. Many seem to be concerned about the integrity of the nation state, the ability of the people (within national boundaries) to order and determine their fates. The bugbears of our time are foreign judges, unelected elites, corporate overlords and, very often, bankers. There is one area where these four (judges, elites, corporates and bankers) come together to 'fight' the nation state. This area is Investor State Dispute Settlement or ISDS.



There is little that excites anti-globalization campaigners more than ISDS. Try searching for #ISDS on social media and you will find horror stories about how the Energy Charter Treaty allows corporations to sue states, hampering the transition to a low carbon economy; how American civil society is rising up against the dispute resolution provisions in NAFTA; how resistance to CETA is following on from fighting against TTIP. Media are awash with concern about foreign corporate interests usurping democracy, placing a legal straitjacket around sovereign discretion, making public wishes and political agendas irrelevant or impossibly expensive. It is all terribly depressing, until you realize that a little bit of constraining sovereign discretion, of limiting democracy, might be exactly what we need.

What is this fearsome beast? Many international investment agreements, bilateral and multilateral (like NAFTA for instance) mandate standards of treatment for investors that are in many ways superior to legal protections offered to nationals. In particular, treaties allow in some instances investors to sue governments if they introduce new laws or policies that might reduce profits. This takes place in investor state dispute settlement (ISDS) tribunals. Lawsuits are brought before international arbitration panels that operate under rules similar to those used for the resolution of international commercial disputes. The main issue about ISDS is that it allows foreign corporations to sue governments not only for hostile behavior that we associate with coups and revolutions (like nationalizing industries and expropriation), but also for policies in the public interest with solid democratic credentials. This is why, while this mechanism is widely accepted in international business, it became hugely controversial when companies started to use it to challenge measures introduced by governments to protect the environment and public health. An illustrative example is Spain. After the country changed its incentives structures for the generation of renewable energy

in the midst of the financial crisis, it got sued by most foreign investors in ISDS under the Energy Charter Treaty (ECT), with some of them actually winning substantial amounts in compensation.

This sounds pretty bad, so why should we not view ISDS as a threat to national wellbeing? The reason is that sometimes we need constraints on sovereign discretion. Democracy can produce less than optimal outcomes (to put it politely) especially in terms of economic policy. Trump and Brexit are contemporary examples. The current US administration has made America an unpredictable trade partner, a potentially rogue state which may violate at will agreements for political reasons. Seen this way, the US is now a state whose sovereign reach needs to be curtailed. Canada, for instance, by maintaining ISDS in NAFTA, could try to prevent Trump from legislating parts of his agenda that may hurt international investors who rely on free trade. This is not an unusual objective. When parties are unpredictable or considered a political risk, external constraints on their policy-making help stabilize the investment environment, providing an additional layer of protection for businesses.

Looking at Brexit, a consequence of ousting the jurisdiction of the European Court of Justice from the UK is that a gap develops in dispute resolution mechanisms. The EU is, understandably, concerned about leaving the rights of its citizens and businesses to the jurisdiction of domestic courts. This is not because it does not trust British judges, but because it does not trust the government that controls the legal framework within which they make decisions. While we do not know yet what the enforcement mechanism will be for any resulting UK-EU deal, ISDS is already exerting a tempering influence on the UK, by raising the price tag of a potentially disorderly Brexit through existing investment deals. This is good for the investment climate and good for the country, regardless of what one thinks of the underlying government policies and their mandate, or lack thereof.

Therefore, contrary to a rather hysterical global debate, ISDS does not make democracy irrelevant. What it does instead is place a price tag on the exercise of sovereign discretion. No one is telling politicians what to do, or how to do it. They can still act within their nationally determined constitutional boundaries. They also have choices even if this means transcending international boundaries, like those established by international investment treaties. What they cannot do is ignore the cost of their discretion. Think of it this way. I am not allowed to park my car on a double yellow line (prohibiting a vehicle from remaining stationary for more than a moment in a specific location). Can I still do it? Yes, I can, but I will have to pay a fine. Double yellows do not take away my freedom, they give it direction -they frame it- for the common good. Constraining sovereign discretion in order to create a predictable investment environment is done in order to entice investors to invest in the country. Making the environment unpredictable, or subjecting it to caprice, democratic or otherwise, can still be done, but it will cost both in terms of compensating existing investors whose legally protected expectations are frustrated, and by poisoning the investment environment for the future. Limiting sovereign discretion can be for a nation's own good.

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SUGGESTED CITATION Glinavos, Ioannis: *In Praise of Limiting Democracy: a Defense of*

ISDS, VerfBlog, 2018/6/27, <https://verfassungsblog.de/in-praise-of-limiting-democracy-a-defense-of-isds/>.